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C O N F I D E N T I A L SECTION 01 OF 02 YEREVAN 000151

SIPDIS

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TAGS: [ECON](#) [EFIN](#) [ETRD](#) [KTDB](#) [AM](#)
SUBJECT: DRAM FALLS 25 PERCENT AFTER CENTRAL BANK ENDS
SUPPORT

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Classified By: DCM Joseph Pennington, reasons 1.4(b,d)

SUMMARY

1. (U) The board of the Central Bank of Armenia (CBA) announced today that it would end its aggressive intervention in support of the Armenian Dram (AMD). Almost immediately, the AMD fell nearly 25 percent. GOAM officials are hopeful that the currency has reached a new equilibrium price, but it may take a few days for the market to sort itself out. From now on the CBA says it will intervene only to mitigate sharp fluctuations in the market. End Summary.

IMMEDIATE 25 PERCENT DROP

2. (U) The CBA's announcement this morning that it would end its support of the Armenian Dram (AMD)--on which it had spent over USD 400 million since October--was followed by an immediate drop in the AMD, which declined from 307 per dollar to 380-390. The market at this point seems to be in panic, with some banks refusing to sell dollars, or with large bid/ask spreads (HSBC initially was buying at 320 and selling at 380), though these began to narrow later in the day as a new equilibrium price around 370 began to emerge. There are anecdotes about stores selling imported items closing down, waiting for the exchange rate to stabilize so they can properly reprice their merchandise.

CBA EXPLAINS DECISION

3. (C) According to CBA Chairman Arthur Javadyan, the decision to let the AMD float again was made after the CBA considered the "worsened terms of trade and the slowing down of the capital inflow growth rate." The new CBA policy will allow the exchange rate to adjust to the requirements of the market, improving the competitiveness of Armenian products and contributing to the creation of new workplaces in the country. The decision was made based on the fact that the "financial system of Armenia is stable, overcapitalized and ready to withstand the challenges of the global crisis." (Comment: While the CBA is correct that the banking system is quite stable, the problems of the Armenian export sector go beyond an overpriced AMD, so we are less confident of the employment-generating impact of this decision. End Comment). Minister of Economy Nerses Yeritsian today also defended the CBA's support of the AMD, asserting that the strategy had helped banks prepare for an eventual devaluation and created stability that will prevent another major devaluation. He predicted that the AMD would settle at under 370 per dollar.

INFLATION EXPECTATIONS

4. (U) As a result of the AMD depreciation, the CBA and IMF expect the 2009 inflation rate to reach 8-9 percent; previously they had predicted four percent. Taking into

consideration risks of a higher inflation rate, and in an effort to discourage currency speculation by banks, the CBA today also increased the refinancing rate one percentage point, to 7.75 percent. The IMF forecasts that the AMD will depreciate by 17-30 percent this year and projects a GDP growth rate of minus 1.5 percent. On a more positive note, persons receiving dollar-denominated foreign remittances will receive more AMD for their dollars.

SUPPORTED BY FINANCIAL INSTITUTIONS

15. (U) The CBA's decision to return to a floating exchange rate is supported both by the World Bank and the IMF, which had reportedly conditioned their aid packages on the CBA allowing the AMD to float freely. The IMF Resident Representative announced today that the IMF Executive Director has recommended that the Executive Board approve a USD 540 million "standby" credit to Armenia, of which USD 240 million will be available immediately after the board decision, expected on March 6. This money will go to the CBA to stabilize its reserves, and follows announcements by the World Bank and the Russian Government of plans to lend Armenia approximately USD 500 million each.

COMMENT

16. (C) The CBA's decision to end its forex intervention has long been a question of "when" rather than "if," given the rate at which it was exhausting its reserves. The decision to do so today lends credence to claims that the GOAM was waiting until after the March 1 anniversary of last year's fatal post-election crackdown to let the AMD fall, so as not to give the opposition more fodder for anti-government demonstrations. It is too early to know how the Armenian public will react to this sudden devaluation; while it was

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widely expected, it may take time for residents to absorb the shock. End Comment.
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